SUMMARY of COOPERATIVE CASES

FARM CREDIT ADMINISTRATION
U. S. DEPARTMENT OF AGRICULTURE
WASHINGTON, D. C.

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Prepared for the

COOPERATIVE RESEARCH AND SERVICE DIVISION

by the

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Comments on accounting-economic aspects of the cases by

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COOPERATIVE RESEARCH AND SERVICE DIVISION

Summary No. 54 August 1952

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The comments on cases reviewed herein represent the personal opinions of the authors and not necessarily the official views of the Department of Agriculture.

TAXABILITY OF REVOLVING FUND CERTIFICATES TO OWNERS

In Summary No. 53, at page 1, the case of Dr. P. Phillips Cooperative, Petitioner v. Commissioner of Internal Revenue, 17 T. C. 1002, was reported. Shortly after this decision, the Tax Court promulgated its decision in P. Phillips, Petitioner (Also Howard and Della Phillips) v. Commissioner of Internal Revenue, 17 T. C. 1027, in which it ruled on certain deficiencies which had been assessed against the three named petitioners. These deficiencies arose when the Commissioner adjusted each petitioner's net income upward by an amount equaling the amounts for which revolving fund certificates were issued to them by the Dr. P. Phillips Cooperative, of which they were members, representing proceeds from marketing operations and receipts from caretaking services.

The findings of fact and the opinion, being brief, are quoted below in full:

Findings of Fact

"The petitioners are P. Phillips, his wife, Della, and their son, Howard. They maintained their books of account and filed their returns for the calendar year 1946 on the basis of cash receipts and disbursements. Their individual returns for that year were filed with the collector of internal revenue for the district of Florida.

"The petitioners are members of Dr. P. Phillips Cooperative, a corporation engaged in marketing fruit and taking care of groves. The petitioners marketed fruit through the cooperative and employed the cooperative to take care of their groves. The receipts of the cooperative exceeded its costs and expenses and it returned a part of that excess to the petitioners in cash as patronage dividends. But it retained all of the net proceeds from its 1946 caretaking activities and a part of the proceeds from the marketing activities. It placed the retained portions in a reserve and issued to the petitioners noninterest-bearing, nonnegotiable, nonassignable revolving fund certificates payable only at the discretion of the Board of Directors, to evidence the amounts retained. Its contracts for caretaking required it to issue such revolving fund certificates but its contracts for marketing did not require it to issue such revolving fund certificates. It was not required by law, by its constitution, or by its by-laws to issue revolving fund certificates for amounts retained as a reserve.

"The following table shows the amounts retained in 1946 from the caretaking operations and from the marketing operations for which revolving fund certificates were issued to the petitioners:

	Caretaking certificates	Marketing certificates
P. Phillips.	$365.64	$920.52
Howard Phillips.	559.69	2,263.23
Della Phillips.	758.15	4,059.05

"The certificates had no fair market value at the times they were issued.

"The petitioners did not report the above amounts as income for 1946. The petitioners, on their returns for 1946, claimed deductions for the expenses of maintaining and taking care of their groves.

"The Commissioner, in determining the deficiencies, adjusted the net income upward by the amounts retained for which revolving fund certificates were issued.

"The oral stipulations of fact and joint exhibits filed in this case are incorporated herein by this reference. The findings of fact in the case of Dr. P. Phillips Cooperative, 17 T. C. 1002, are incorporated herein by this reference.

Opinion

"Murdock, Judge: The Cooperative was under no obligation either to return the amounts to the members or to issue revolving fund certificates for the amounts it retained as a reserve from marketing operations. They belonged to and were taxable income of the Cooperative. Dr. P. Phillips Cooperative, 17 T. C. 1002. Cf. Harbor Plywood Corporation, 14 T. C. 158, affirmed per curiam 187 F. 2d 734; George Bradshaw, 14 T. C. 162, both of which dealt with amounts which did not belong to or represent taxable income of the cooperative there in question. Dr. P. Phillips Cooperative voluntarily issued revolving fund certificates against the amounts retained from marketing operations. Those certificates had no fair market value and did not represent income to the recipients on that basis. The Cooperative never made the funds themselves subject to the demand of any member so that constructive receipt might apply. The funds belonged to and were retained by the Cooperative. They were not income of the members for 1946. Furthermore, if a member ever receives any cash or thing of value in lieu of the certificates, that will represent an additional 'amount realized' from the sale of his 1946 crop which will be taken into income at that later date if it represents unreported profit. The Commissioner has advanced no sound reason for including these amounts in the income of the petitioners for 1946.

"The situation with respect to the amounts retained by the Cooperative from its 1946 caretaking activities is different. It has been held in Dr. P. Phillips Cooperative, supra, that those amounts never belonged to the Cooperative. It was required by its contracts with the members to issue revolving fund certificates for the funds thus retained. The members agreed in advance that those funds, which continued to belong to them, could be retained by the Cooperative for the special purpose of the reserve. Those members deducted as expenses of their business the amounts which they transmitted to the Cooperative for caretaking services, including the amounts retained. At least the evidence does not show the contrary and the assumption is logical.

> It developed for the first time in 1946 that the amounts under discussion were in excess of the caretaking expenditures of the Cooperative for its fiscal year 1946, continued to belong to the members, did not represent true expenses of the business of those members, and reduced to that extent the amount otherwise allowable as an expense deduction to those members. It then appeared that these amounts represented, not expenses of the members, but amounts which, they had agreed in advance, could be used by the Cooperative for a special purpose from which the contributors of the funds desired and expected to benefit. Thus, although the retained amounts, which never ceased to belong to the members, were not income of the contributors for 1946, nevertheless the result reached by the Commissioner in determining the deficiency is correct since the deductions taken for expenses in 1946 should be reduced to correspond to the amounts actually spent by each member as caretaking expenses. Cf. Estate of William H. Block, 39 B. T. A. 338, affd. 111 F. 2d 60, certiorari denied 311 U.S. 658; Walter M. Marston, 41 B. T. A. 847; Beacon Auto Stores, Inc., 42 B. T. A. 703; Acampo Winery & Distilleries, Inc., 7 T. C. 629; M & E Corporation, 7 T. C. 1276."

The decision in this case is, of course, consistent with the holding in Dr. P. Phillips Cooperative, supra. Amounts which in that case were held taxable to the agricultural cooperative were in this case held not taxable to the members. Amounts which in that case were held not taxable to the cooperative, because of its prior mandatory contractual obligation to return them to the members, were in this case held to be property of the members and, therefore, the true expenses of the members should have been reduced to the extent of such amounts.

(R. J. Mischler)

Some of those who advise farmers on taxation matters are of the opinion that farmers filing their Federal income tax returns on the cash receipts and disbursements basis (as contrasted with the accrual basis) are not obliged to report for taxation the receipt of any noncash distributions made by cooperative associations, such as shares of capital stock, revolving capital certificates, etc.

In the Phillips case, and in other recent cases, it is clearly apparent that the Tax Court is in earnest when it rules that noncash distributions of a cooperative association, made pursuant to an express agreement with its members, must be taken up promptly in the income tax returns of the individual member-patrons.

(George J. Waas)

EXTORTED MONEY TAXABLE INCOME; WILCOX CASE LIMITED

In Rutkin v. United States, 72 S. Ct. 571, decided March 24, 1952, the Supreme Court, by a vote of 5 to 4, held that money obtained by extortion is income taxable to the extortioner under section 22(a) of the Internal Revenue Code. The Court's previous ruling in Commissioner of Internal Revenue v. Wilcox, 327 U.S. 404, 66 S. Ct. 546, 90 L. Ed. 752, that embezzled funds were not taxable income to the embezzler is limited "to its facts." For a brief discussion of the Wilcox decision and the application of the principles stated therein to cooperatives see Summary No. 38, page 10.

The majority opinion in the Rutkin case concludes that the general rule taxing unlawful gains of many kinds should be applied. It states that there "has been a widespread and settled administrative and judicial recognition of the taxability of unlawful gains of many kinds under section 22(a)." As an example, it refers to the taxability of lawful gains secured by the fraud of the taxpayer and argues that "it would be an extraordinary result to hold here that petitioner is to be tax free because his fraud was so transparent that it did not mislead his victim and his victim paid him the money because of fear instead of fraud." With respect to the Wilcox case, the majority opinion states:

> "We do not reach in this case the factual situation involved in Commissioner of Internal Revenue v. Wilcox, 327 U.S. 404, 66 S. Ct. 546, 90 L. Ed. 752. We limit that case to its facts. There embezzled funds were held not to constitute taxable income to the embezzler under § 22(a). The issue here is whether money extorted from a victim with his consent induced solely by harassing demands and threats of violence is included in the definition of gross income under § 22(a). We think the power of Congress to tax these receipts as income under the Sixteenth Amendment is unquestionable. The broad language of § 22(a) supports the declarations of this Court that Congress in enacting that section exercised its full power to tax income. We therefore conclude that § 22(a) reaches these receipts."

The dissenters apparently feel that "A tax interpretation which Congress has left in effect for six years is thus altered largely as a consequence of a change in the Court's personnel." Justice Black, in his dissent, also states:

> "In Commissioner of Internal Revenue v. Wilcox, 327 U.S. 404, 66 S. Ct. 546, 90 L. Ed. 752, decided February, 1946, we held that embezzled money did not constitute taxable income to the embezzler under § 22(a) of the Internal Revenue Code. We there pointed out that the embezzler had no bona fide legal or equitable claim to the money, was under a definite legal obligation to return it to its rightful owner, and consequently had no more received the kind of 'gain' or 'income' which Congress has taxed than if he had merely borrowed money. One who extorts money not owned him stands in this precise situation. He has neither legal nor equitable claim to the extorted money and is under a continuing obligation to return it to its owner."

In view of the Court's virtual rejection of the reasoning used in the Wilcox case, a question arises as to the continued utility of that decision to support the position of cooperatives that money which they are under a definite and unconditional obligation to repay or return is not income and, therefore, is not taxable.

(R. J. Mischler)

It does appear certain that the cooperatives will no longer point to the Wilcox case in support of their income tax status since that case is now overshadowed by the new thinking evidenced in the Rutkin decision.

But it is significant to point out that the cooperatives have many other decisions of much closer analogy on which to rely. The Wilcox and Rutkins cases at best offer only a rather tenuous similarity to the tax position of a cooperative.

On the one hand we consider the so-called obligation of a criminal to return embezzled or extorted funds to their rightful owner; on the other hand there comes into view a valid, legal contract (most often in writing) between a respectable cooperative association and its respectable members, through which it is voluntarily agreed that the cooperative's operating proceeds at all times shall be vested in its patrons, rather than in the cooperative itself. There is a wide gap between what might be called involuntary restitution and a return of funds by voluntary contractual agreement. It would appear, therefore, that in the Rutkins case the wish to punish an extortioner might be father to the thought of taxing him.

(George J. Waas)

COOPERATIVE ORGANIZED UNDER "COOPERATIVE MARKETING ACT" MUST LIMIT ITS MEMBERS TO PERSONS AUTHORIZED BY THAT ACT

In State ex rel. Steere v. Franklin County Farm Bureau, et al., 172 Kansas 179, 239 Pac. 2d 570, the Kansas Supreme Court held that the Kansas Farm Bureau, Inc., organized under the "cooperative marketing act" of Kansas (Chap. 148 of the Laws of 1921, now G.S. 1949, 17-1601 to 17-1631, incl.), may not provide in its by-laws for the admission of organizations to its membership which are not authorized under the cooperative marketing act to become members of the cooperative.

The Kansas Farm Bureau, Inc., had provided in its by-laws that county farm bureau organizations should be eligible for membership in it. The Franklin County Farm Bureau, which was organized and operated under the Kansas Farm Bureau Act (B.S. 1949, 2-601 to 2-607), had been paying dues as a member of the State organization. This action was brought to enjoin the county farm bureau from making payments to the State organization on the grounds that the county organization had no authority to contribute funds to, or become a member of, the State organization.

The court reviewed the factual situation as to the organization of the county organization and found that there was no authority in the law

under which it was organized which permitted it to become a member of the State organization. The court then went on to review the statutory provisions relating to the incorporation of cooperatives under the cooperative marketing act of the State, and concluded that such act did not authorize the county farm bureau to become a member of a cooperative organized under such act. In this connection, the court commented as follows:

"The act provides for the admission to membership of 'persons'. One of the definitions of the word 'person' in G.S. 1949, 17-1602, is an 'association.' 'Association' as used in the act is defined in G.S. 1949, 17-1602 as any corporation organized under the act. It is clear it was not the intention of the Legislature in enacting Chapter 148 of the Session Laws of 1921 to provide for a county farm bureau becoming a member of a corporation organized pursuant to G.S. 1949, 17-1601 et seq.

"G.S. 1949, 17-1605 sets out in detail the powers of associations organized pursuant to the act. Nowhere is there in that section any reference to the work for which farm bureaus may be organized and receive public funds. By the time this act was enacted the farm bureau act had been on our statute books for several years. Their work was well known and had it been the intention of the Legislature that farm bureaus organized under G.S. 1949, 2-601 et seq. could become members of associations organized under G.S. 1949, 17-1601 et seq. then it could have so provided. The fact it did not do so is persuasive with us here. In fact it is clear that the two acts, each cover an entirely distinct and separate field of activities.

"Defendants point out that the by-laws of the Kansas Farm Bureau provide its object shall be in part: 'The purposes for which it is formed are: To strengthen, develop, and correlate the work of the county farm bureaus in their efforts to promote the development of the most profitable and permanent system of agriculture, the most wholesome and satisfactory living conditions; the highest ideals in home and community life and a general interest in the business of farming, and in rural life.'

"They ask 'In the absence of statutory provision why may not the local farm bureau accomplish their worthy purpose and objectives by correlating their work with other like associations in other counties through the very medium organized for the purpose, namely the Kansas Farm Bureau?' The answer is because the act under which the county farm bureaus are organized and receive public funds does not provide as one of the purposes for which the bureaus may be organized, the joining or becoming affiliated with any other organization. Their purposes are limited to education through the employment of a county agricultural agent. It was generally recognized what field they were to cover. Similar organizations came into being throughout the nation following the enactment of the legislation by congress, to which reference has already been made here.

"In the second place, we have difficulty in discerning in what manner the Kansas Farm Bureau was organized for the purpose of carrying out

any work in connection with county farm bureaus. We have had no such purpose pointed out to us in the statute, G.S. 1949, 17-1601 et seq.

"Defendants point out that the by-laws of the Kansas Farm Bureau provide that each county farm bureau shall be eligible for membership in it. Neither one of the statutes we have discussed here contain any such provision. The Kansas Farm Bureau cannot by its charter or by-laws assume power or functions not conferred by the statute under which it was organized. See State, ex rel., v. Wheat Farming Co., 137 Kan. 697, 22 P. 2d 1093."

(R. J. Mischler)

ANTITRUST ACTION AGAINST MINK FUR COOPERATIVE

In Midwest Fur Producers Association v. Mutation Mink Breeders Association, 102 F. Supp. 649, the plaintiff and others brought suit against the Mutation Mink Breeders Association, a cooperative corporation organized under the laws of Wisconsin, alleging that such association is violating the antitrust laws and is claiming trade-mark rights to which it is not entitled. The suit was brought in the United States District Court for Minnesota, Fourth Division, and defendant moved to dismiss the action upon the ground that it was not subject to the court's jurisdiction, since it was neither an inhabitant of Minnesota nor transacting business therein. The court granted this motion without prejudice to plaintiff's right to bring the action in an appropriate forum. The case is reported here merely to add further weight to the oft repeated statement that the actions of cooperatives carry no special immunity from the antitrust laws.

(R. J. Mischler)

REDRIED TOBACCO AN AGRICULTURAL COMMODITY UNDER INTERSTATE COMMERCE ACT

In April, the District Court for the Eastern District of Kentucky rendered an opinion in Interstate Commerce Commission v. Yeary Transfer Company, Inc., (presently unreported) upholding the position of the Department of Agriculture that redried tobacco is an agricultural commodity within the meaning of section 203 (b) (6) wnich exempts interstate haulers of "agricultural commodities (not including manufactured products thereof)" from the certificate and permit requirements of the Interstate Commerce Act. The Interstate Commerce Commission had sought to enjoin the Yeary company from transporting mechanically redried tobacco in interstate commerce without appropriate operating authority issued by the Commission.

(R. J. Mischler)

DECISION OF THE TAX COURT AFFIRMED IN NATIONAL TAX EQUALITY ASSOCIATION CASE

On April 15, 1952, the United States Court of Appeals for the Eighth Circuit at St. Louis, Missouri, affirmed the decision rendered on October 31, 1950,

by the Tax Court of the United States (see Summary No. 49, page 8) in the case of Roberts Dairy Company v. Commissioner of Internal Revenue. This decision, reported in 195 F. 2d 949, had the effect of holding that the National Tax Equality Association in 1943, the year it was organized, and in all the years thereafter, engaged primarily in carrying on propaganda for the purpose of persuading Congress to enact legislation unfavorable to cooperatives. The decision is of considerable interest to farmers' cooperatives because it affirms the Tax Court's position that contributions made toward the support of the National Tax Equality Association (which has taken a stand against the present income-tax position of coopertives and other mutuals) cannot be deducted in computing the Federal income tax of the contributor.

(R. J. Mischler)
(George J. Waas)

INFORMATION RETURNS ON PATRONAGE REFUNDS

By publication in the Federal Register of June 4, 1952, the Commissioner of Internal Revenue has issued T.D. 5907, which amends Income Tax Regulations 111 to conform to paragraphs (c) and (d) of Section 314, Revenue Act of 1951. The Cooperative Research and Service Division of the Farm Credit Administration has issued a "(Revised) Supplement No. 1 to Miscellaneous Report 156" which explains and comments upon these regulations.

Copies of this publication may be secured on request while a supply is available from the Director of Information and Extension, Farm Credit Administration, U.S. Department of Agriculture, Washington 25, D. C.

(R. J. Mischler)

The new regulations published as Treasury Decision 5907 concern the statutory requirement that cooperatives shall make annual information returns to the Commissioner of Internal Revenue on Forms 1096 and 1099 covering patronage dividends paid or allocated to any patron in the amount of $100 or more during each calendar year beginning with 1951.

All farmers' marketing and purchasing associations are affected by the regulations, as well as other types of cooperative organizations, but rural electrification associations and certain life and mutual insurance associations, as well as irrigation and telephone companies are specifically exempted.

(George J. Waas)

TAXABILITY TO MEMBERS OF CERTIFICATES OF PREFERRED STOCK AND CAPITAL RESERVE CREDITS

The Tax Court of the United States held on March 19, 1952, that the petitioners, who were members of a tax-exempt farmers' marketing cooperative, (1) received and realized income upon the receipt of certificates of preferred stock to the extent of the fair market value of the certificates, which it determined to be equal to their par value; and (2) did

not realize income on the share of the net income which was merely credited to the capital reserve account of the cooperative. The case is William A. Joplin, Jr., et al., Petitioners, v. Commissioner of Internal Revenue, Respondent, 17 T.C. No. 188.

The significant facts, as summarized by the Court, were as follows:

> "Petitioners William A. Joplin, Jr., Joseph F. Kohn and S. Crews Reynolds were members of a tax-exempt farmers' marketing cooperative corporation, reporting their income on the cash receipts and disbursements basis of accounting. In the taxable years involved, the net earnings of the cooperative were allocated and distributed to its members in the form of credits to its capital reserve account and the issurance of certificates of its preferred stock having a par value of $25 per share."

The opinion, in full, reads as follows:

> "The question presented is whether income was realized by the taxpayers, in the respective taxable years involved, upon the allocation and distribution of the net savings or earnings of the Osceola Products Company to the petitioners who were members of the association, in the form of credits to its capital reserve account and the issuance of preferred stock of such corporation.
>
> "The petitioners, William A. Joplin, Jr., Joseph F. Kohn and S. Crews Reynolds, were members of the Osceola Products Company, a nonprofit cooperative corporation exempt from tax under the provisions of section 101 (12) of the Internal Revenue Code, in effect in the taxable years involved herein. All of the income tax returns of the taxpayers for the taxable years in question were filed on a cash receipts and disbursements basis of accounting.
>
> "The taxpayers contend that the income of a tax-exempt farmers' marketing cooperative represents income to the cooperative; that the portion thereof allocated to the capital reserve account and the portion represented by the issurance of preferred stock is not taxable income to a member reporting on a cash basis until the cash is realized therefrom; and, in the alternative, if the preferred stock represents the receipt of something of value to be reported as income in the year of receipt then the amount to be reported is the fair market value of the preferred stock at the time of its receipt. It is conceded by the taxpayers that the $25 par value preferred stock had a fair market value equal to one-half its par value.
>
> "The taxpayers argue that the cases relied upon by the respondent such as United Cooperatives, Inc., 4 T.C. 93; Colony Farms Cooperative Dairy, Inc., 17 T.C. 688, involved nonexempt cooperatives and not the patrons; and that the cases of Harbor Plywood Corporation, 14 T.C. 158, affirmed per curiam, 187 F. 2d 734; and George Bradshaw, 14 T.C. 162, which involved the question of realization of income by members of a

nonexempt cooperative reporting on an accrual basis of accounting, are not controlling here.

"Since the filing of briefs herein, this Court has decided Estate of Wallace Caswell, Deceased, 17 T.C._____(Jan. 18, 1952), in which we held that members of a tax-exempt cooperative on a cash basis of accounting realized income upon the receipt of certificates representing their interests in the capital reserve of the cooperative, which certificates they were free to sell, exchange or assign to the extent of the fair market value thereof.

"We think the Caswell case is controlling here on the question of the realization of income by the petitioners on the receipt of the certificates of preferred stock of the cooperative. We, therefore, hold that the taxpayers realized income to the extent of the fair market value of those certificates in the years of their receipt.

"The respondent's determination that the petitioners are also taxable on their proportional shares of the net earnings of the cooperative which were credited to the capital reserves but in respect of which no certificates or other evidence of such interests were issued to the members can be sustained only on the theory of constructive receipt and reinvestment of such amounts by the petitioners. Since the cooperative had a right under its charter and its by-laws, and under the provisions of section 101 (12) of the Code, to retain a portion of the net earnings for operating capital reserve, such retained reserves were its income, although exempt from tax, and not income to the patrons until actually distributed, or made available to them. See United Cooperatives, Inc., supra; Harbor Plywood Corporation, supra; and Dr. P. Phillips Cooperative, 17 T.C._____.

"We do not think that the taxable or nontaxable status of the cooperative determines the tax liability of the patrons on such nondistributable profits. In no case should the constructive receipt theory apply, we think, unless at some time the earnings of the cooperative were made available to or were subject to the control of the patron.

"Therefore, with respect to the amounts credited to capital reserve we hold that the taxpayers received no taxable income.

"There remains for determination the fair market value of the certificates of preferred stock. The charter of the Osceola Products Company authorized the issuance of preferred stock on the basis of a par value of $25 per share. It is a generally recognized principle of law that where a corporation is authorized to issue its shares of stock having a par value it can not issue such shares for a consideration less than par. When the certificates in question were issued, the net earnings of the cooperative were charged with the sum of $25, the par value of the shares. The certificates of preferred stock were transferable, bore six per cent noncumulative dividends, and could

be redeemed upon call of the board of directors for cash at the par value plus dividends thereon declared and unpaid. Upon dissolution, the preferred shares were entitled to receive the par value plus declared and unpaid dividends before any distribution upon the common stock. The record further establishes that in each of the respective taxable years in question various amounts of preferred stock were sold and issued, for which the corporation received the par value of $25 per share.

"At the hearing, the taxpayers offered the testimony of two local bankers who expressed the opinion that the fair market value of the preferred shares was around 50 per cent of their par value. We regard such opinion evidence of little probative value in the light of the other facts and circumstances disclosed by this record. We hold that the fair market value of the preferred stock was the equivalent of its par value, and have so found as a fact. Cf. Estate of Wallace Caswell, Deceased, supra."

It is not clear from the facts stated whether petitioners in the tax years in question were given notice in any form of the allocations made to them in the form of credits to the "capital reserve account" of the cooperative. Apparently, however, no such notice was given since the Court at one place describes the amounts in question as being "net earnings of the cooperative which were credited to the capital reserves but in respect of which no certificates or other evidence of such interest were issued to the members." (Underscoring added.) It seems reasonable to conclude, in view of the decisions in P. Phillips, et al., 17 T.C. 1027 (see this Review, supra), and Estate of Wallace Caswell, Deceased, 17 T.C. 1190 (Summary No. 53, p. 5), that it was the lack of notice to the petitioners which was the controlling factor in the Court's decision that mere book credits did not cause the patrons to realize income.

(R. J. Mischler)

I have discussed this case with a number of informed people, including some Government tax authorities. Generally they agree with Mr. Mischler's conclusion above that it is likely the Court's main reason for ruling the Joplins did not realize income on the reserve credits was founded on the absence of notification to them of the amount of such credits.

There are, however, some who continue to feel that the controlling reason for the Court's decision centered in its expression that:

"In no case should the constructive receipt theory apply, we think, unless at some time the earnings of the cooperative were made available to or were subject to the control of the patron."

It is, of course, possible that the Court intended this remark to refer only to the absence of notification, rather than to mean that reserve credits cannot be taxed to patrons until the time of their cash redemption.

According to my knowledge of their viewpoints, tax administration authorities take the position that all operating proceeds of a bona fide cooperative are constructively received by its owner-member-patrons by virtue of the fact that any portion held back by the cooperative is authorized to be held back in the by-laws or other legal papers which furnish the contractual basis for the dealings between the cooperative and its members. This authorization to hold back cash funds has been considered tantamount to a constructive receipt of cash by the member and a constructive return of the same amount to the association as a capital investment or as a loan (as the case may be).

This view is clearly evidenced in the following excerpt from Income Tax Information Release No. 2 issued by the Commissioner of Internal Revenue on April 13, 1950:

> "For Federal income tax purposes, the amounts which are includible in the gross income of the patrons to whom such distributions are made are not restricted to amounts distributed in cash. Distributions by cooperatives in the form of capital stock, or in any form other than cash, should be included in the gross income of the patrons to the same extent that such distributions would be included if paid in cash. This rule is applicable to patrons who file their Federal income tax returns on the basis of cash receipts and disbursements as well as those who file their returns on the accrual basis."

At that time the Commissioner did not stress the necessity for actual notification to patrons, but it can be fairly assumed that in the use of the word distributions he meant to imply notification.

Although of no application to the Joplin case, the June 4, 1952 regulations (T. D. 5907) issued by the Commissioner with respect to the tax status of the exempt group of farmers' cooperatives under the Revenue Act of 1951, emphasize the need for notification to patrons. Otherwise, patronage dividends will not be deductible in computing a cooperative's taxable income.

(George J. Waas)